

## Internal Revenue Service

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Date:

June 29, 2015

Portfolio =

Trust =

Adviser =

Subadviser =

Dear :

This is in response to the letter submitted by your authorized representative dated December 23, 2014, requesting a ruling concerning the tax ownership of the Portfolio for federal income tax purposes. The tax ownership of Portfolio will determine if Portfolio is exempted from the excise tax imposed by § 4982 of the Internal Revenue Code of 1986, as amended (the “Code”).

### FACTS

The Portfolio is a separate series of the Trust, a Massachusetts business trust. The Portfolio intends to qualify as a regulated investment company under Subchapter M of the Code. The Portfolio is a series of an open-end management investment company registered under the Investment Company Act of 1940, as amended (the “1940 Act”). The Portfolio is managed by Adviser and Subadviser.

The Portfolio represents its principal investment strategy is to actively allocate the Portfolio’s assets among a broad range of income producing investments. The Portfolio may invest all or a portion of its assets in exchange-traded funds (“ETFs”) that qualify as regulated investment companies, including ETFs affiliated with Subadviser. Through investments in ETFs, the Portfolio will obtain exposure to fixed income securities, equity securities, and other asset classes. The percentage of the Portfolio’s

assets invested in an ETF will not be fixed and will be subject to change by the Adviser or Subadviser at any time.

Shares of the Portfolio will be offered to life insurance company segregated asset accounts to serve as an investment vehicle for variable annuity contracts and variable life insurance policies (collectively referred to as "Variable Contracts"). The Portfolio intends to comply with the diversification requirements of § 817(h).

The Portfolio makes the following additional representations:

1. Except as otherwise permitted by Income Tax Regulation §1.817-5(f)(3), all of the beneficial interest in the Portfolio are held directly or indirectly by one or more segregated asset accounts of one or more life insurance companies and public access to the Portfolio is available exclusively through the purchase of a variable contract within the meaning of § 817(d).
2. The life insurance companies whose segregated asset accounts hold or will hold shares of the Portfolio are life insurance companies within the meaning of § 816(a).
3. Each segregated asset account that will hold shares of the Portfolio will be a separate account registered with the Securities and Exchange Commission as a unit investment trust under the 1940 Act or will be exempt from registration under the 1940 Act.
4. There is not, and there will not be, any arrangement, plan, contract, or agreement between Adviser or Subadviser and any Variable Contract holder ("Contract Holder") regarding the availability of the Portfolio as a subaccount under the variable contract or the specific assets to be held by the Portfolio.
5. Other than a Contract Holder's ability to allocate variable contract premiums, and transfer amounts in the respective life insurance company segregated asset account to and from the life insurance company subaccount corresponding to the Portfolio, all investment decisions concerning the Portfolio will be made by Subadviser, subject to supervision by Adviser and the Trust's Board of Trustees. The percentage of the Portfolio's assets invested in a particular regulated investment company, including an ETF, will not be fixed in advance of any Contract Holder's investment and will be subject to change by Adviser or Subadviser at any time.
6. A Contract Holder cannot and will not be able to direct the Portfolio's investment in any particular asset or recommend a particular investment or investment strategy, and there will not be any agreement or plan between Adviser or

Subadviser and a Contract Holder regarding a particular investment of the Portfolio.

7. No Contract Holder will be able to communicate directly or indirectly with Adviser or Subadviser concerning the selection, quality, or rate of return on any specific investment or group of investments held by the Portfolio.
8. A Contract Holder will not have any real time knowledge of the Portfolio's specific portfolio holdings. A Contract Holder will not have any legal, equitable, direct or indirect ownership interest in any of the assets of the Portfolio. A Contract Holder only will have a contractual claim against the respective life insurance company offering the Variable Contract to receive cash from such life insurance company under the terms of his or her Variable Contract.

## **LAW AND ANALYSIS**

### Investor Control Rules

If the separate account assets underlying the variable contract are considered the assets of the life insurance company that issues the contract and not the property of the contract holder, § 817 governs the tax treatment of the contract. If the separate account assets underlying the contract are considered the assets of the contract holder, the contract holder is taxed on the income derived from the investment assets under § 61.

In general, the holder of legal title is the owner of the property and is taxed on the income derived from the property. However, if a person other than the holder of legal title possesses the "benefits and burdens" of ownership, that person is attributed ownership of property for tax purposes. See, e.g., Frank Lyon Co. v. United States, 435 U.S. 561 (1978); Helvering v. Clifford, 309 U.S. 331 (1940). The Supreme Court summarized this principle in Corliss v. Bowers, 281 U.S. 376, 378 (1930), stating that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed -- the actual benefit for which the tax is paid."

The Service applied these general tax ownership principles in a series of "investor control" rulings. Rev. Rul. 77-85, 1977-1 C.B. 12; Rev. Rul. 80-274, 1980-2 C.B. 27; Rev. Rul. 81-225, 1981-2 C.B. 12; Rev. Rul. 82-54, 1982-1 C.B. 11; Rev. Rul. 2003-91, 2003-2 C.B. 347; and Rev. Rul. 2003-92, 2003-2 C.B. 350. The rulings stand for the proposition that contract holders possessing control over the investment of the separate account assets (in addition to the other benefits and burdens of contract ownership) are the owners of separate account assets for federal income tax purposes even if the insurance company retains possession of and legal title to those assets.

Rev. Rul. 77-85, considered a situation in which the individual purchaser of a variable annuity contract retained the right to direct the custodian of the account supporting that variable annuity to sell, purchase, and exchange securities or other assets held in the

custodial account. The purchaser also was able to exercise an owner's right to vote account securities either through the custodian or individually. The Service concluded that the purchaser possessed "significant incidents of ownership" over the assets held in the custodial account. The Service reasoned that if a purchaser of an "investment annuity" contract can select and control the investment assets in the separate account of the life insurance company issuing the contract, then the purchaser is treated as the owner of those assets for federal income tax purposes. Thus, any interest, dividends, or other income derived from the investment assets would be included in the purchaser's gross income.

In Rev. Rul. 80-274, the Service, applying Rev. Rul. 77-85, concluded that, if a purchaser of an annuity contract could select and control the certificates of deposit supporting the contract and could withdraw all or a portion of the cash surrender value of the contract before the starting date, then the purchaser would be considered the owner of the certificates of deposit for federal income tax purposes. Similarly, Rev. Rul. 81-225, concluded that the purchaser of an annuity contract was considered the owner of mutual fund shares funding the insurance company's annuity contracts if the mutual fund shares were available for purchase by the general public. Rev. Rul. 81-225 also concluded that, if the mutual fund shares were only available through the purchase of an annuity contract, then the sole function of the fund was to provide an investment vehicle that allows the issuing insurance company to meet its obligations under its annuity contracts. Accordingly, if the mutual fund shares were only available through the purchase of an annuity contract, they would be considered owned by the insurance company. Finally, in Rev. Rul. 82-54, the purchaser of certain annuity contracts could allocate premium payments among three funds employing different investment strategies (for example, between stock, bonds, or money market instruments). The purchaser also had an unlimited right to reallocate contract value among the funds prior to the maturity date of the annuity contract. Interests in the funds were not available for purchase by the general public, but were instead only available through purchase of an annuity contract. The Service concluded that the purchaser's ability to choose among general investment strategies either at the time of the initial purchase or after, was not sufficient control to cause the contract holders to be treated as the mutual fund share owners.

In 1984, the Eighth Circuit addressed the tax ownership issue in the context of a variable annuity contract. Christoffersen v. United States, 749 F.2d 513 (8th Cir. 1984). Upon purchasing the contract, the taxpayers could allocate premiums among mutual funds and could change the allocation at any time. The taxpayers bore the full investment risk and could withdraw any or all of the investment after seven days' notice. In addition, the taxpayer was not required to exercise the annuity feature of the contract. The Eighth Circuit concluded that the taxpayers "surrendered few of the rights of ownership or control over assets of the sub-account." *Id.* at 515. The court held that, for federal income tax purposes, the taxpayers owned the mutual fund shares that funded the

variable annuity. The taxpayers were thus required to include in gross income any gains, dividends, or other income derived from the mutual fund shares.

In Rev. Rul. 2003-91, a variable contract holder did not have control over segregated account assets sufficient for the Service to deem the variable contract holder the owner of the assets. The variable contracts at issue were funded by a separate account that was divided into 12 subaccounts. The issuing insurance company could increase or decrease the number of subaccounts at any time, but there would never be more than 20 subaccounts available under the contracts. Each subaccount offered a different investment strategy. Interests in the subaccounts were available solely through the purchase of a variable life or variable annuity contract that qualified as a variable contract under § 817(d). The investment activities of each subaccount were managed by an independent investment adviser. The contract holder would not make any arrangement, plan, contract, or agreement with the issuing insurance company or independent investment adviser as to the availability of a particular subaccount, a subaccount's investment strategy, or assets a subaccount would hold. Other than a contract holder's right to allocate premiums and transfer funds among the available subaccounts, the issuing insurance company or the independent investment adviser made in their sole and absolute discretion all investment decisions concerning the subaccounts. A contract holder had no legal, equitable, direct, or indirect interest in any of the assets held by a subaccount but had only a contractual claim against the issuing insurance company to collect cash in the form of death benefits or cash surrender values under the contract. The Service concluded that based on the facts and circumstances, the contract holder did not have control over the separate account or any subaccount asset. Therefore the contract holder did not possess sufficient incidents of ownership over the assets supporting the variable contracts to be deemed the assets' owner for federal income tax purposes.

In Rev. Rul. 2003-92, the purchasers of variable annuity and variable life insurance contracts were able to allocate their premiums among 10 different subaccounts. Each subaccount invested in a partnership. None of the partnerships was a publicly traded partnership under § 7704 and all the partnerships were exempt from registration under the federal securities laws. Interests in each partnership were sold in private placement offerings and were sold only to qualified purchasers that were accredited investors or to no more than 100 accredited investors. In the ruling, the Service held that the contract purchasers were the partnership interests' owners if interests in the partnership interests were available to the general public for purchase. The Service further held that if the contract purchasers were considered the partnership interests' owners, the contract purchasers must include any interest, dividends, or other income derived from the partnership interest in gross income in the year in which the income is earned.

In Rev. Rul. 2007-7, 2007-1 C.B. 468, which clarified and amplified Rev. Rul. 81-225 and Rev. Rul. 2003-92, the Service held that the holder of a variable contract is not treated as the owner of an interest in a RIC that funds the variable contract solely

because interest in the same RIC are also available to investors described in §1.817-5(f)(3).

### Section 4982

Section 4982(a) imposes a tax on every regulated investment company for each calendar year equal to 4 percent of the excess (if any) of — (1) the required distribution for such calendar year, over (2) the distributed amount for such calendar year.

Section 4982(f)(2) and (f)(4) provides exemptions from such excise tax for any calendar year if at all times during such calendar year each shareholder in such company was a segregated asset account of a life insurance company held in connection with variable contracts (as defined in § 817(d)) or another regulated investment company described in § 4982(f).

### **ANALYSIS**

In the revenue rulings discussed above, the Service took the position that if a variable life insurance policy or variable annuity contract holder possesses sufficient incidents of ownership over the assets supporting the contract, the contract holder is viewed for federal income tax purposes as the underlying assets' owner. As a result, the contract holder is currently taxed on any income and gains attributable to the underlying assets. The determination of whether a variable life insurance policy or variable annuity contract holder possesses sufficient incidents of ownership over the separate account assets underlying the variable life insurance contract or variable annuity contract depends on all the relevant facts and circumstances. See Rev. Rul. 2003-91. In the instant case, the Contract Holders do not have any control over the Portfolio's investments, including Portfolio's investments in other regulated investment companies and ETFs affiliated with Subadviser.

### **CONCLUSION**

Based on the facts presented and representations made, the Portfolio's investment in other regulated investment companies, including ETFs affiliated with the Subadviser, will not cause the Contract Holders to be treated as the Portfolio's shares' owners for federal income tax purposes.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Sarah Lashley  
Assistant to Branch Chief, Branch 4  
(Financial Institutions & Products)

cc: